

Which Alternative Strategies Fit Your Portfolio?

December 2017

Simon Fox, Senior Investment Specialist
Aberdeen Asset Management



We have been through an amazing period of change

Technology



2000



2007



2010



2015

Source: Aberdeen Asset Management

We have been through an amazing period of change

Politics



First Euro notes



Twin Towers,
terror, conflict
and Arab spring



Obama Trump



Grexit and Brexit



Rise of China

We have been through an amazing period of change

Companies



2004



2006



2009



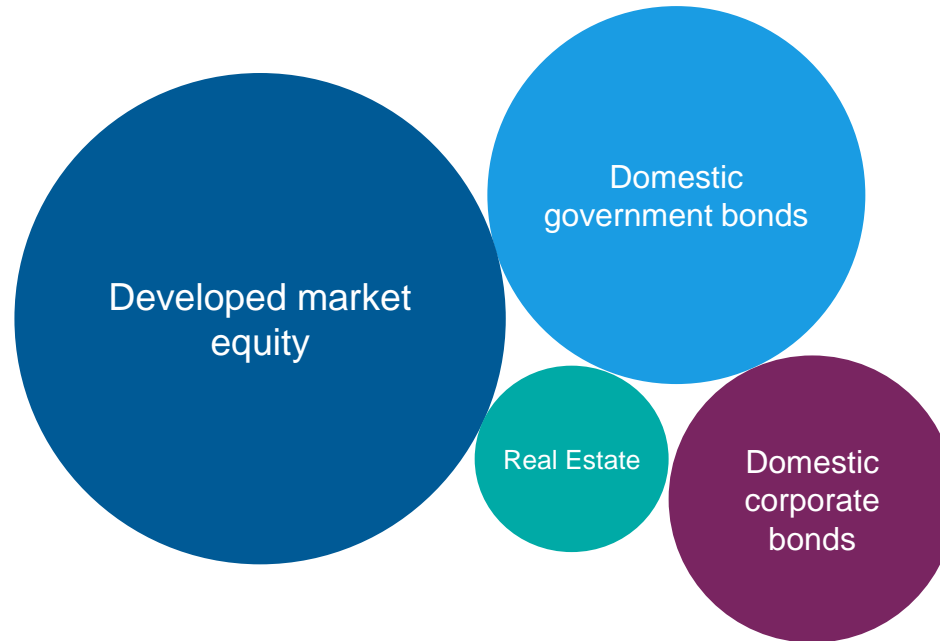
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We have been through an amazing period of change

... and in institutional investing

Changing investment universe

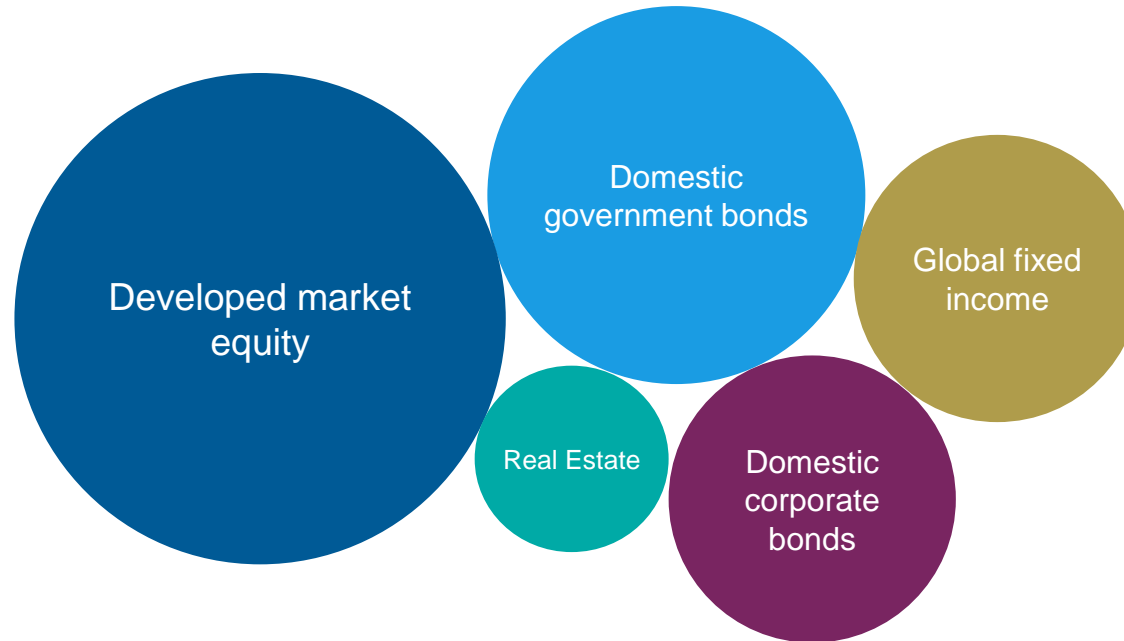
2002



Source: Aberdeen Asset Management, incorporating data from Mercer Search Trends

Changing investment universe

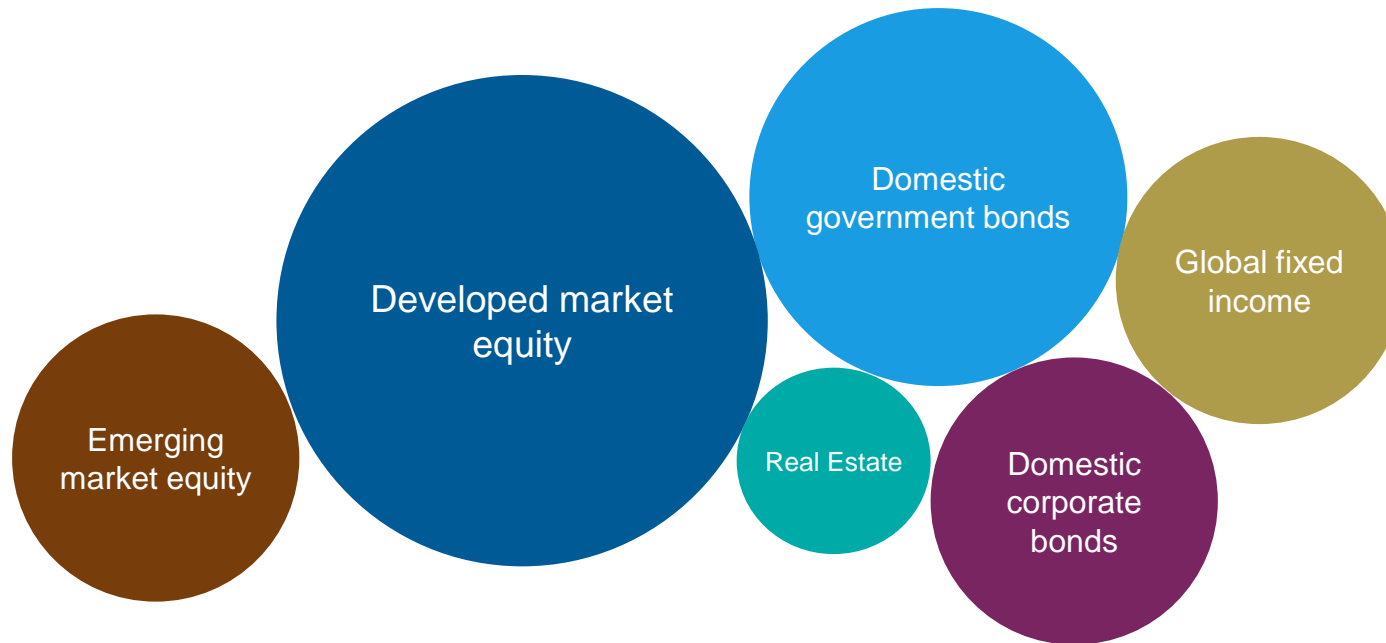
2003



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Changing investment universe

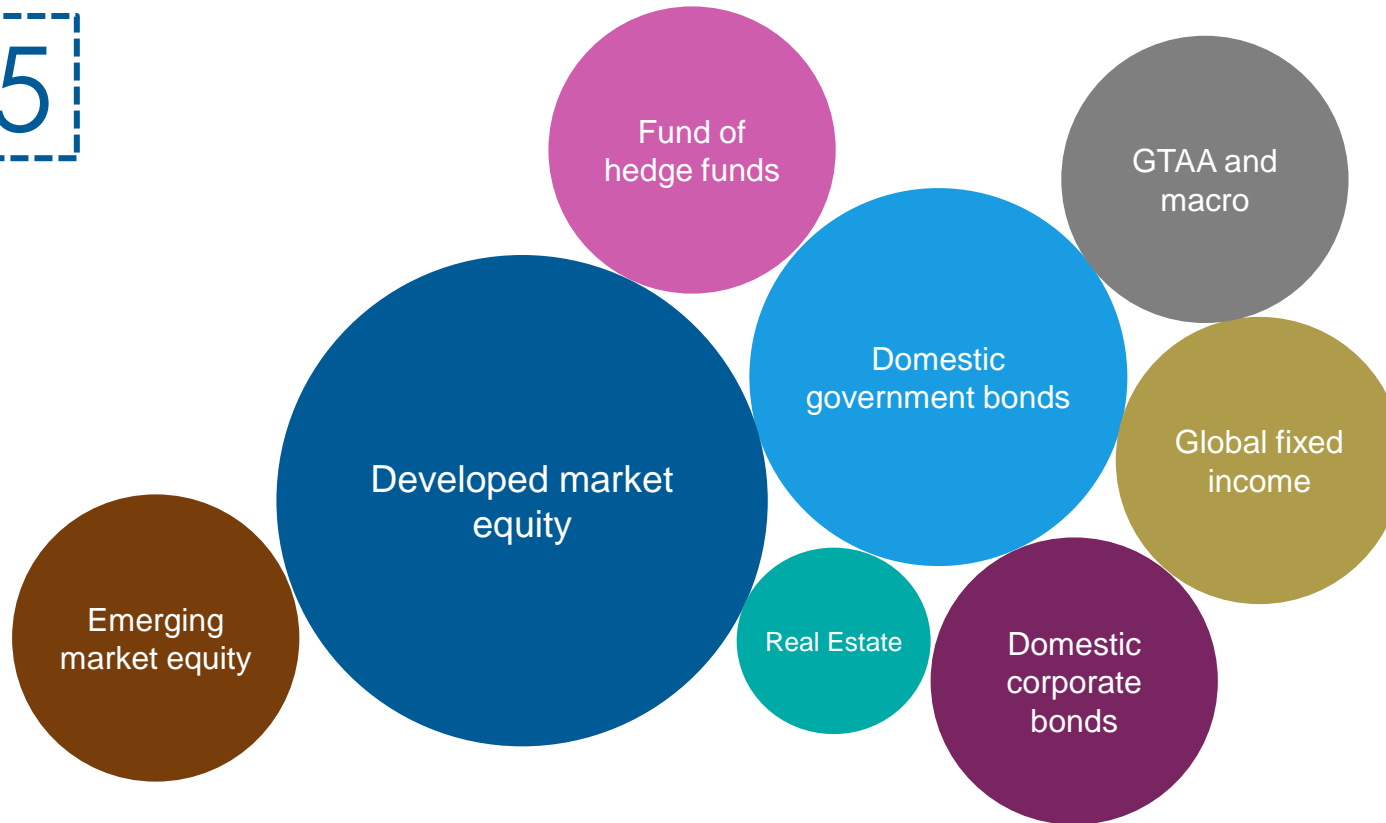
2004



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Changing investment universe

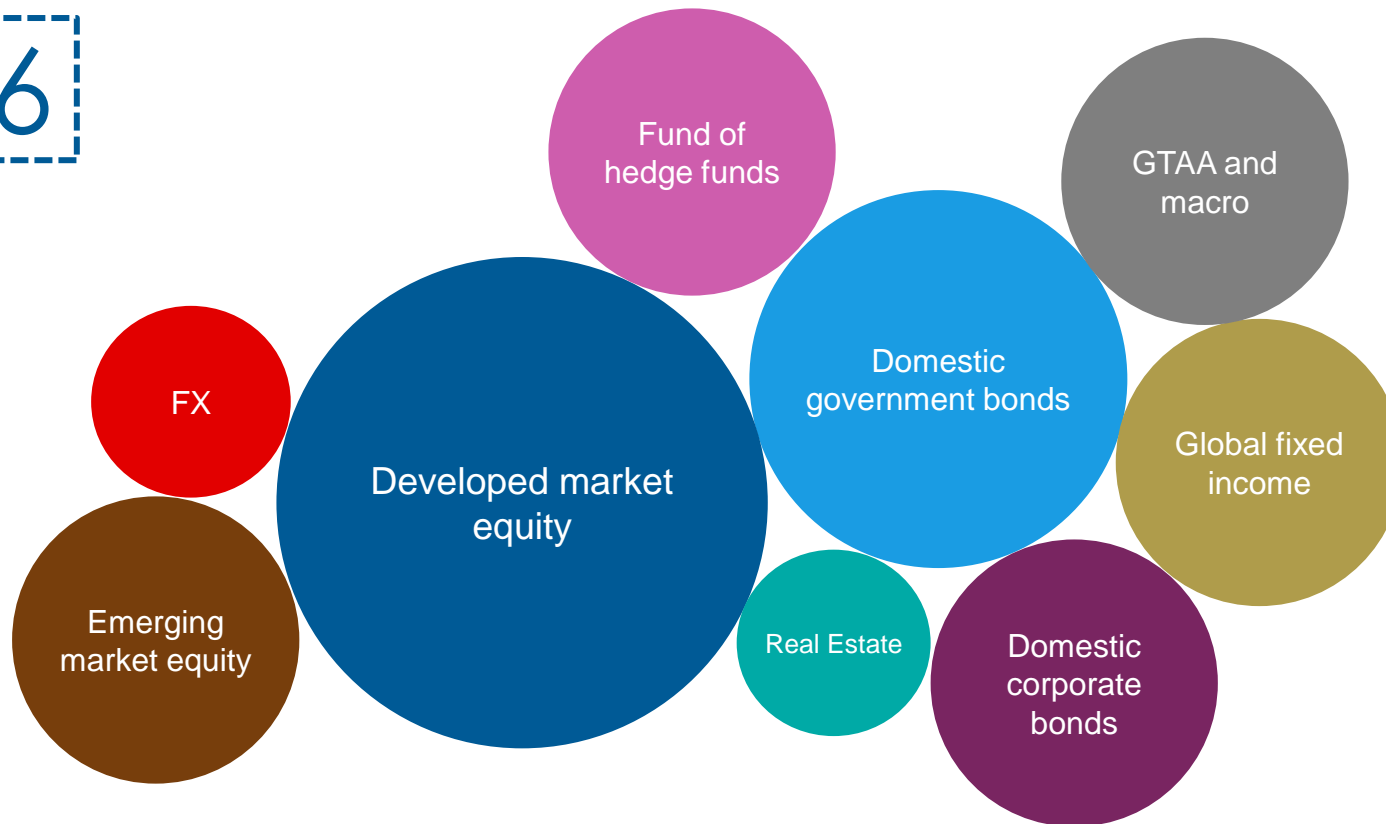
2005



Source: Aberdeen Asset Management, incorporating data from Mercer Search Trends

Changing investment universe

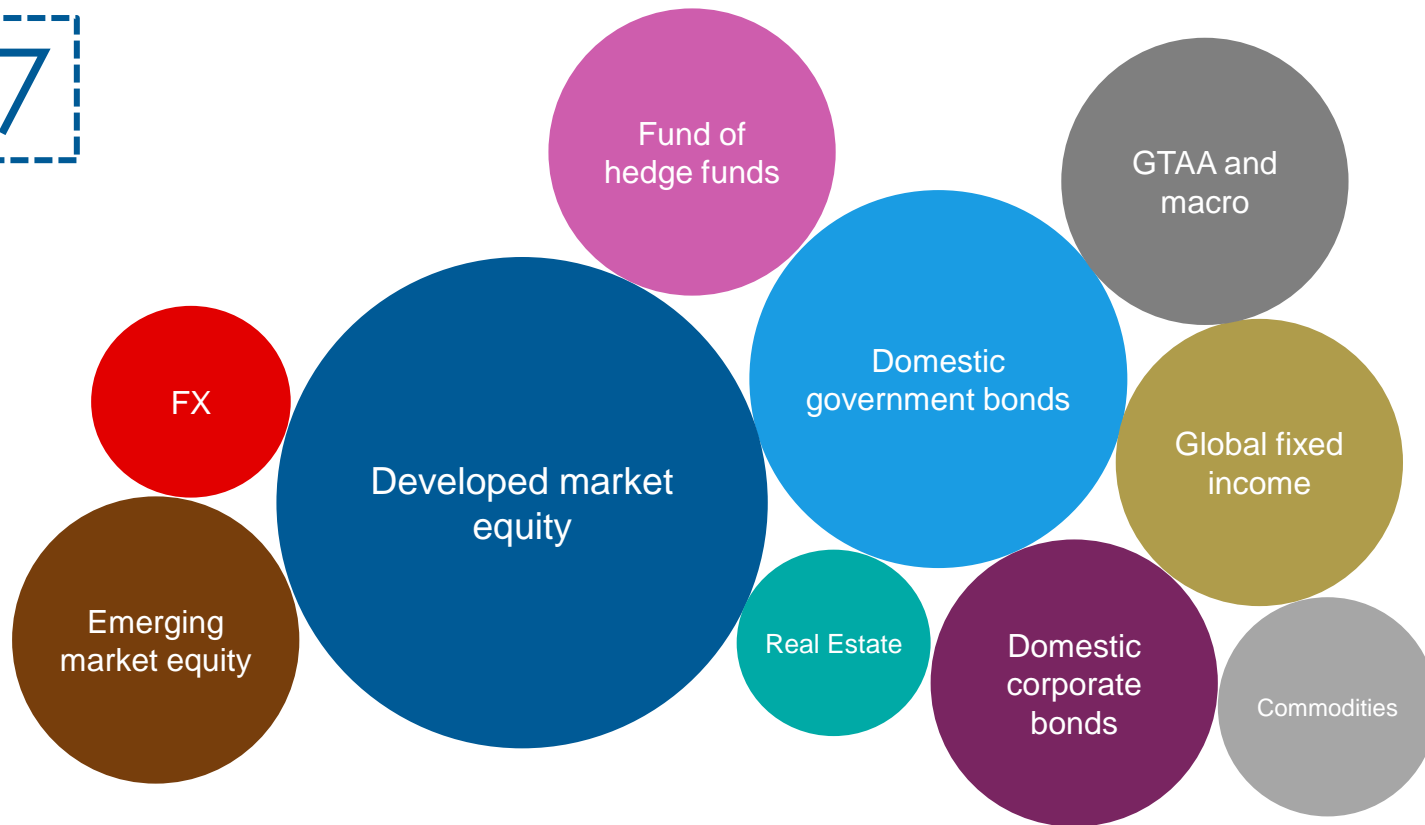
2006



Source: Aberdeen Asset Management, incorporating data from Mercer Search Trends

Changing investment universe

2007



Source: Aberdeen Asset Management, incorporating data from Mercer Search Trends

Changing investment universe

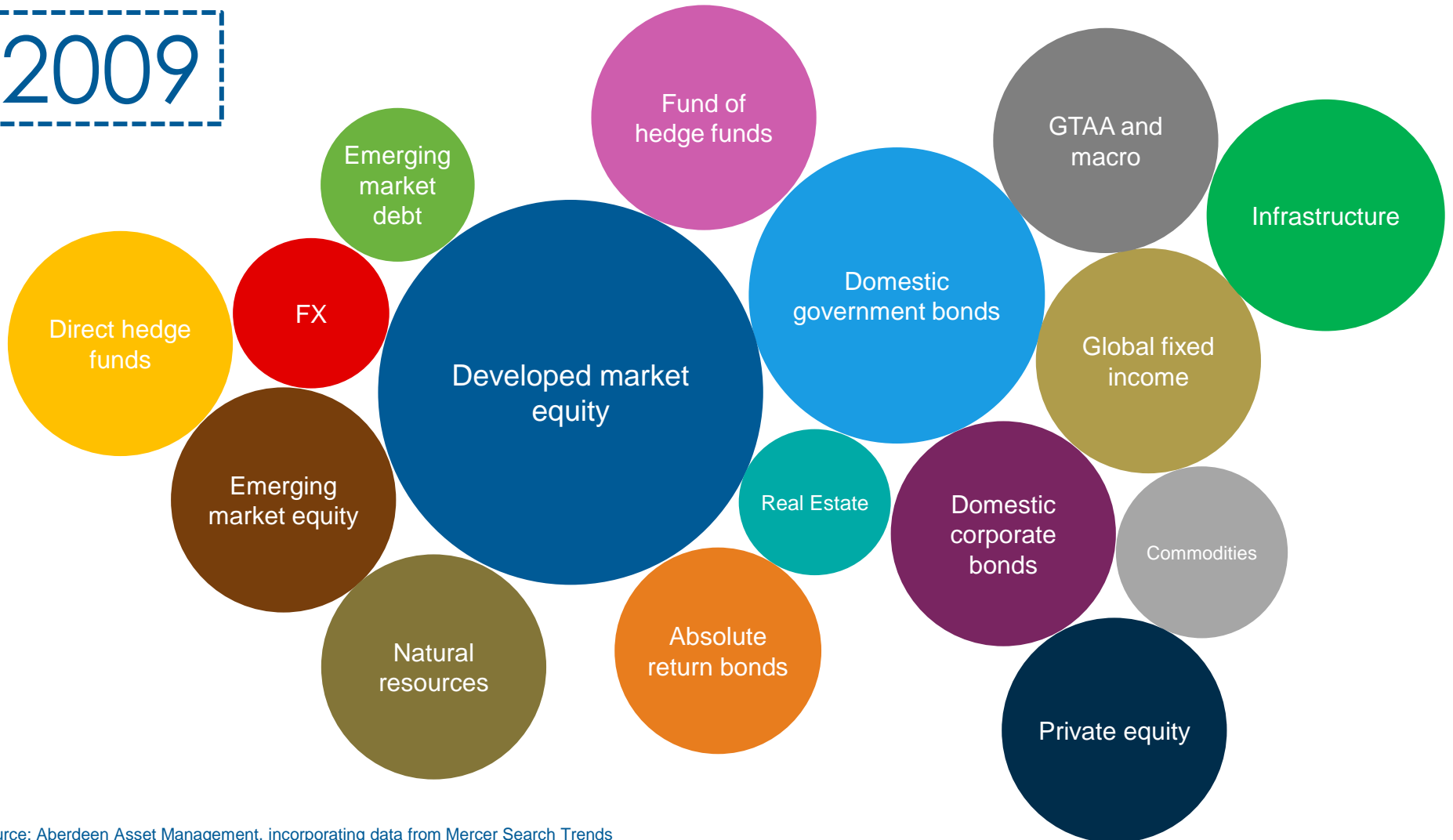
2008



Source: Aberdeen Asset Management, incorporating data from Mercer Search Trends

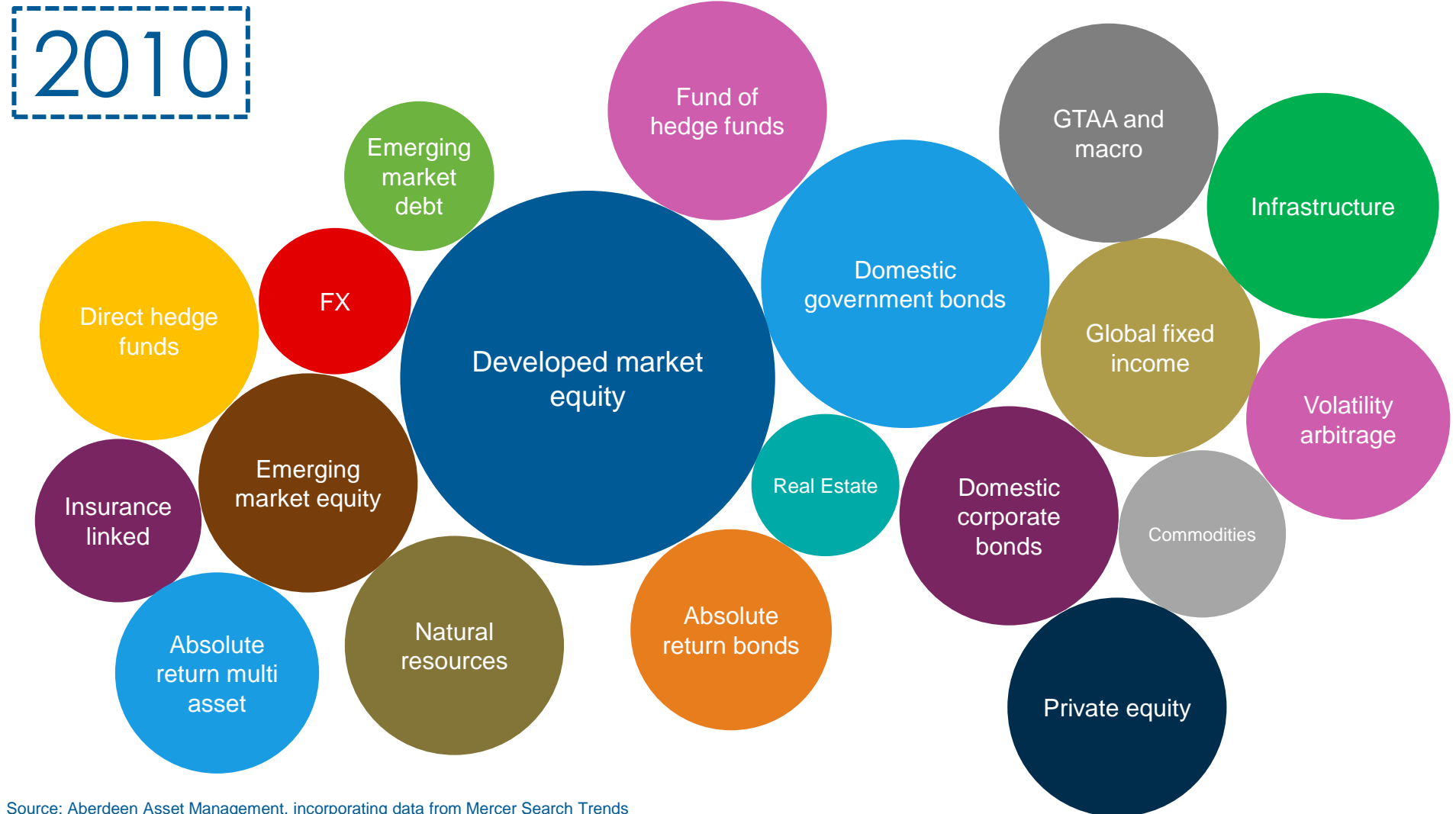
Changing investment universe

2009



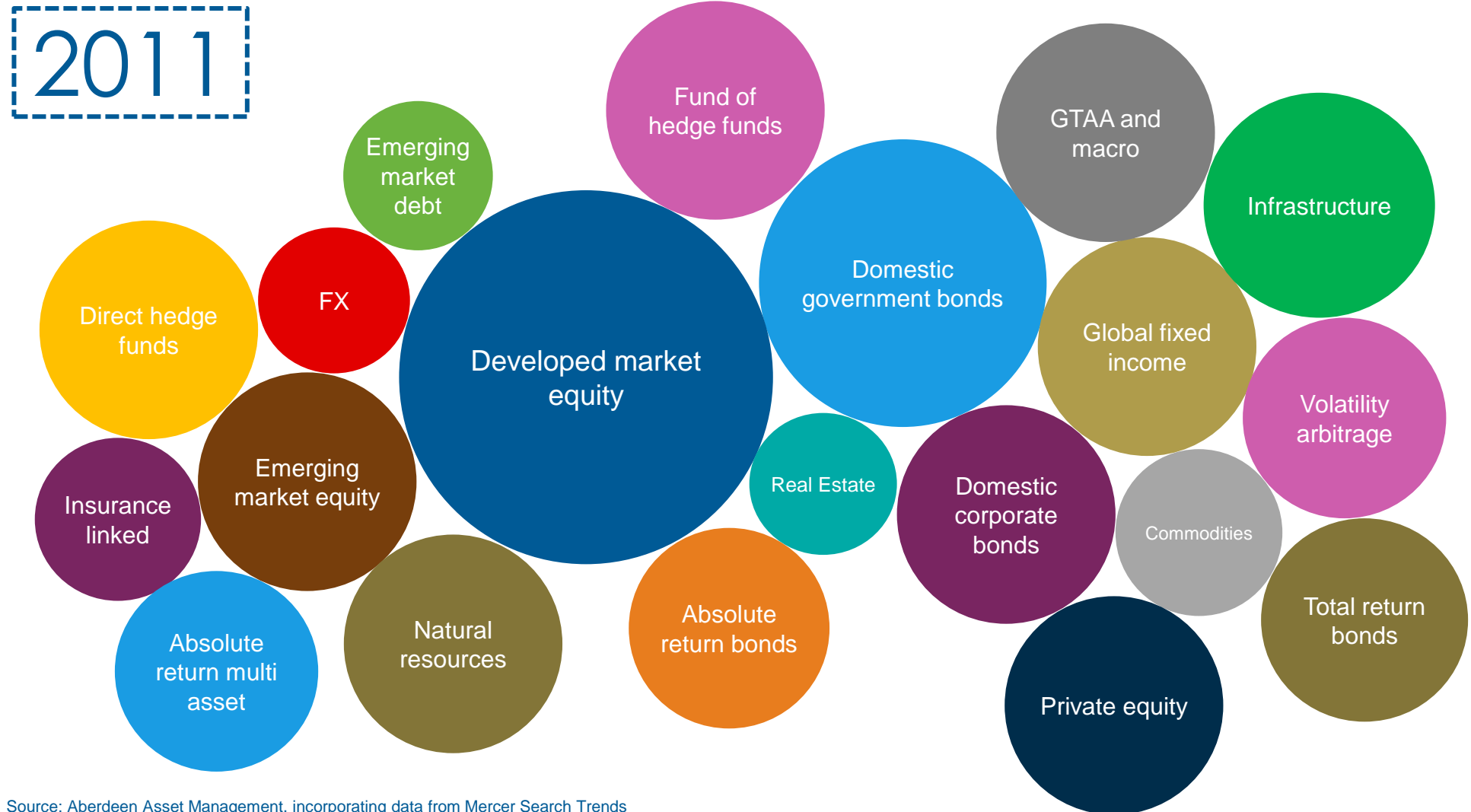
Source: Aberdeen Asset Management, incorporating data from Mercer Search Trends

Changing investment universe



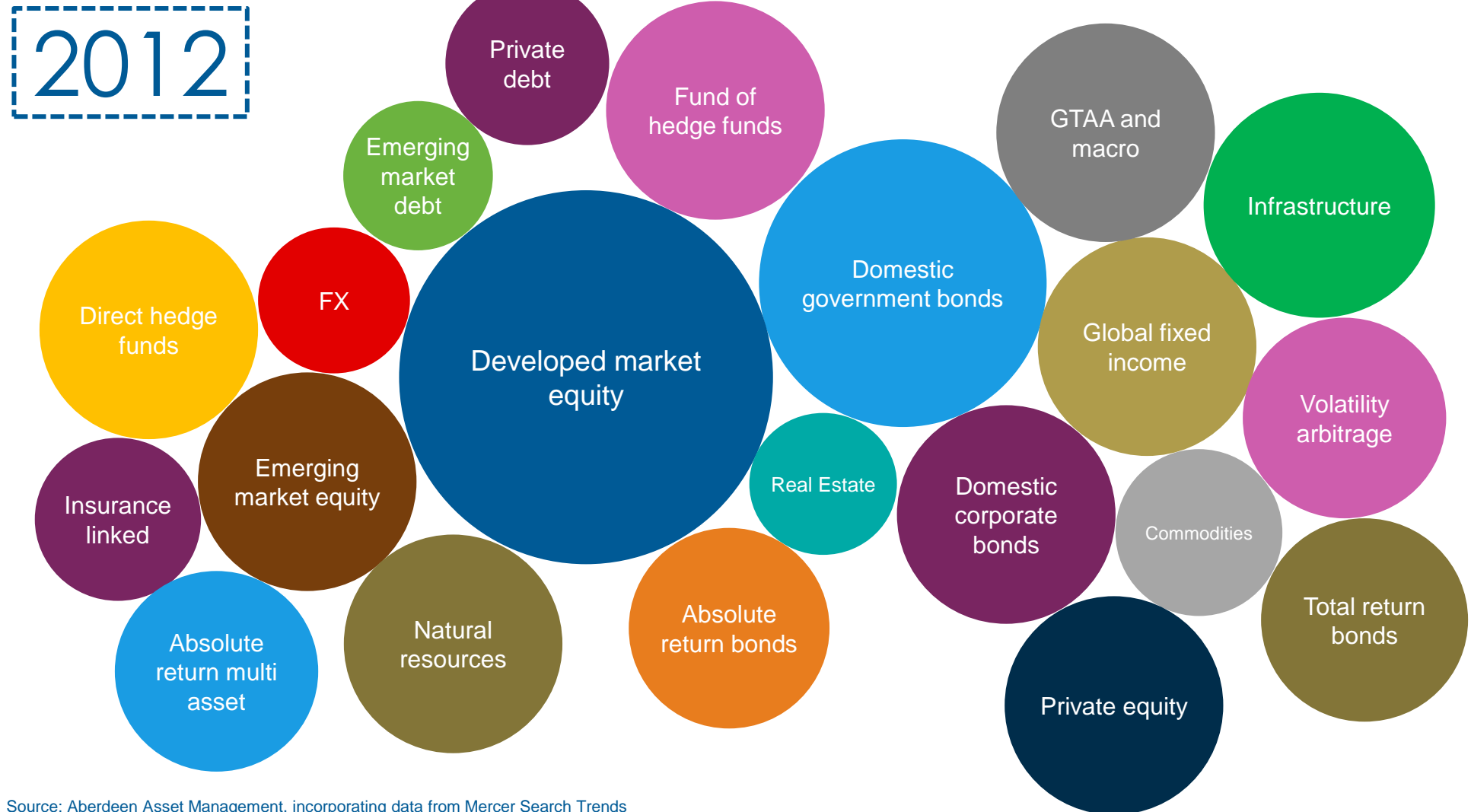
Source: Aberdeen Asset Management, incorporating data from Mercer Search Trends

Changing investment universe



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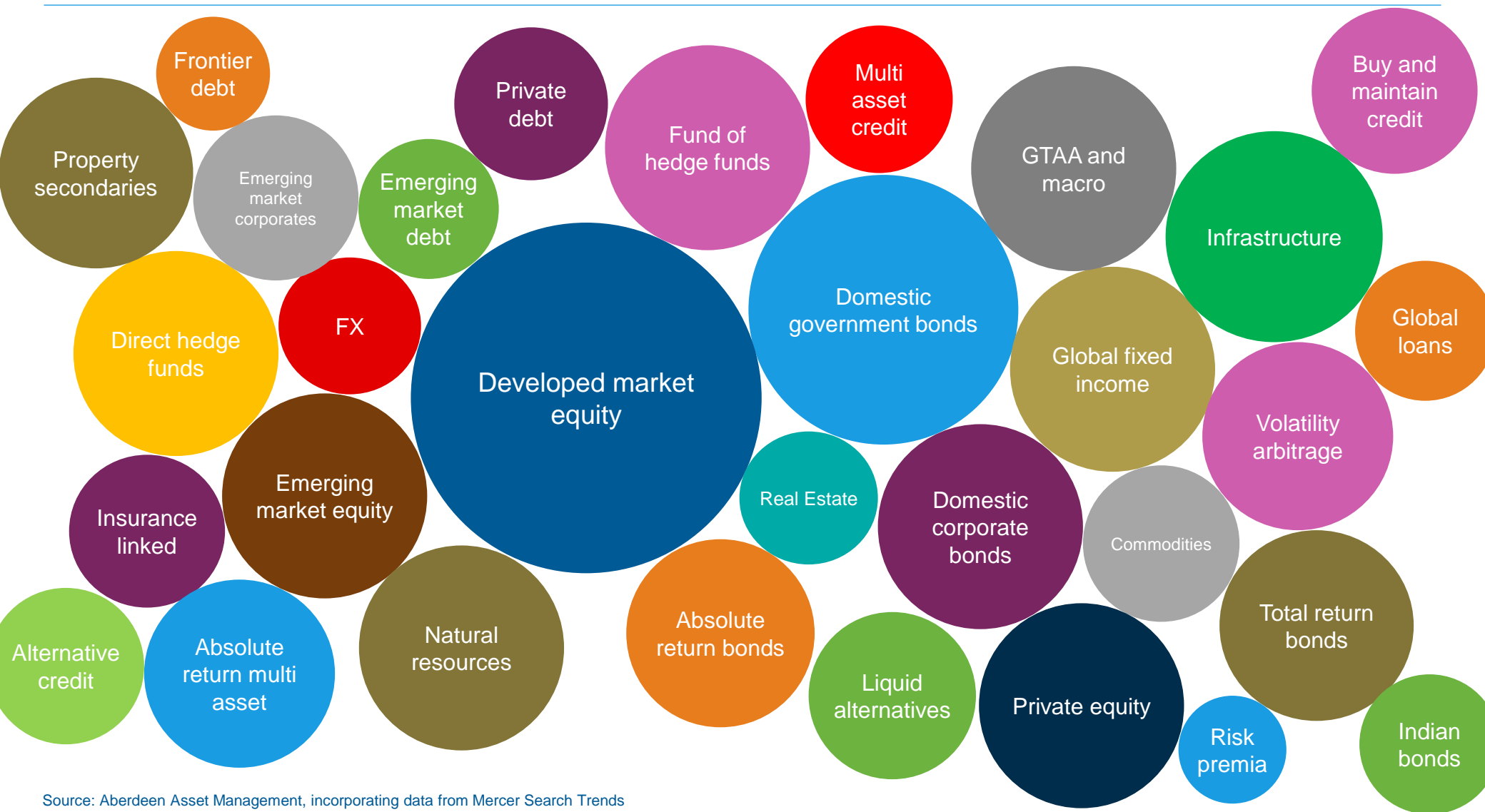
Source: Aberdeen Asset Management, incorporating data from Mercer Search Trends

Changing investment universe



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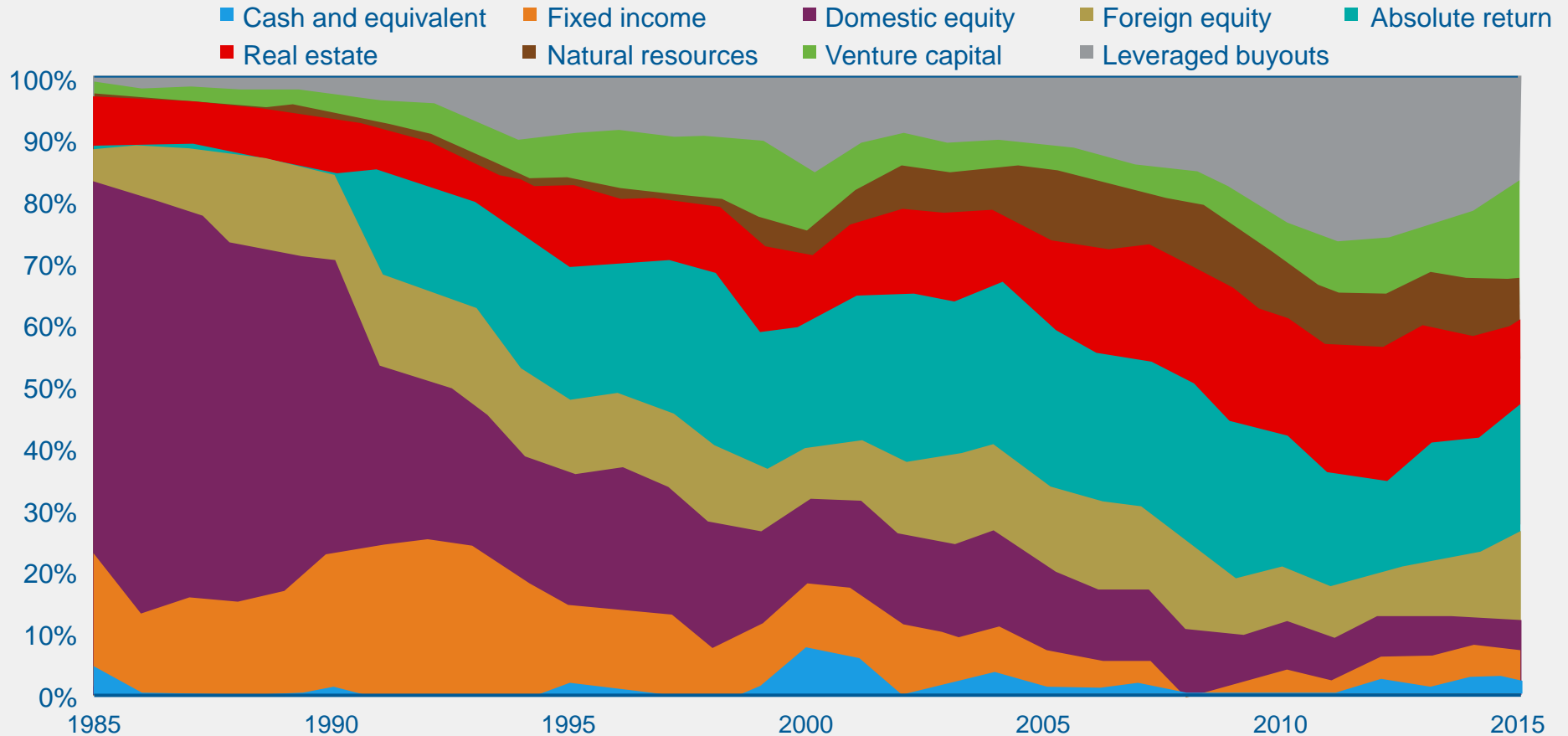
Today's opportunity set



Source: Aberdeen Asset Management, incorporating data from Mercer Search Trends

The world's largest investors already have more diversified asset mixes

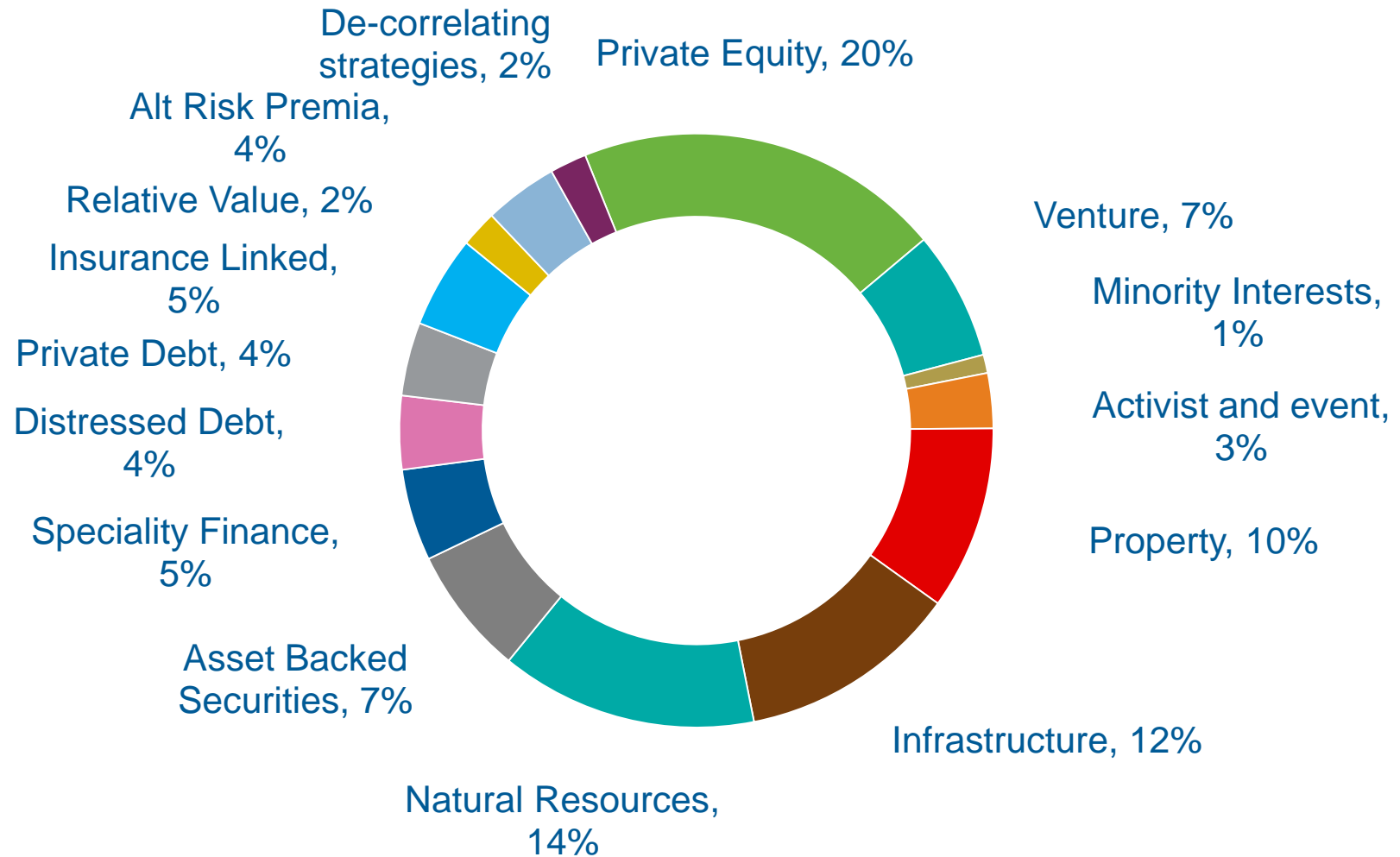
Yale endowment



Past performance is not a guide to future returns

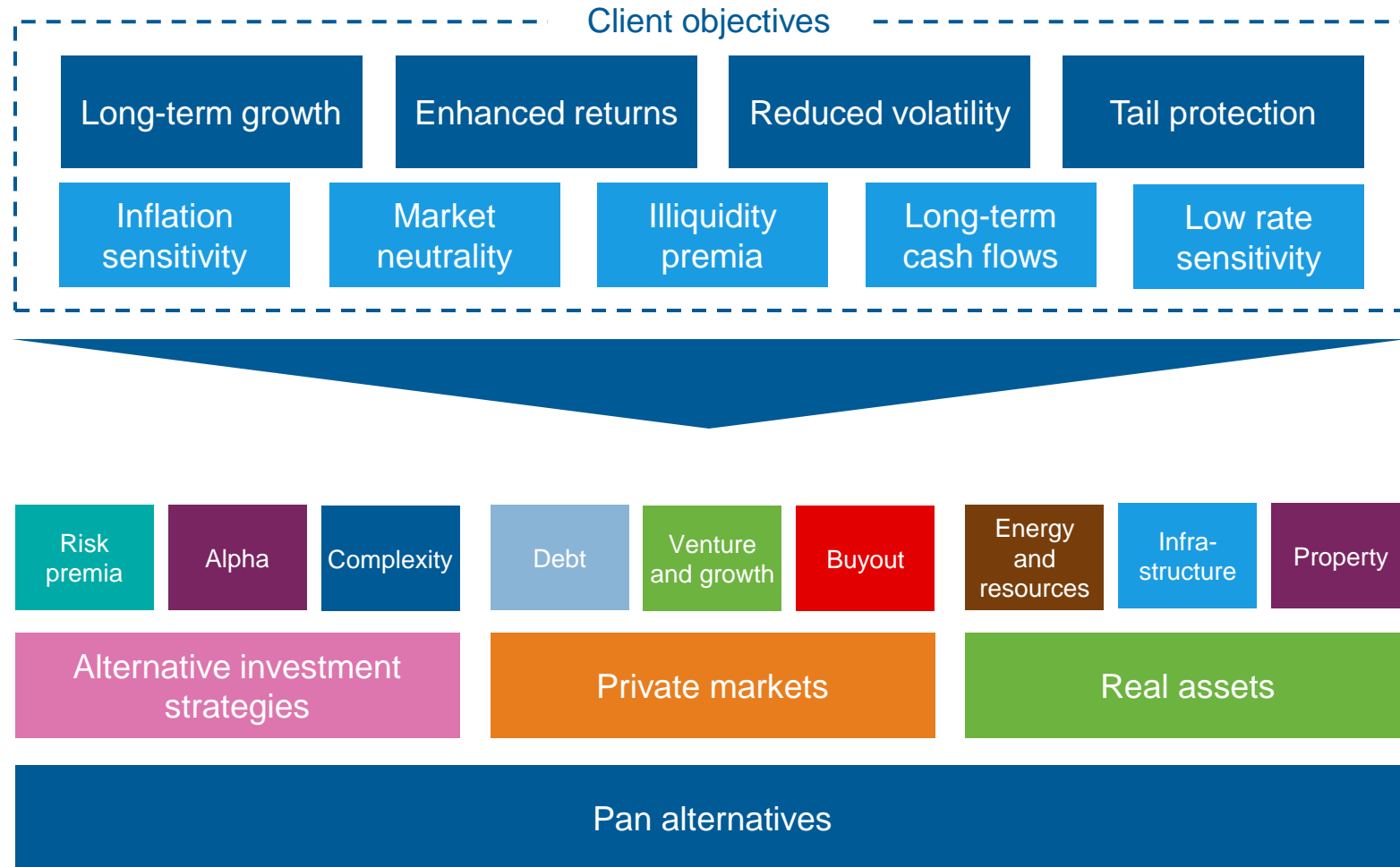
Source: Yale Investment Office, 2016.

Our pan-alternatives model portfolio: growth, real assets and diversification



Source: Aberdeen, 2017. Model portfolio for illustrative purposes only.

So not whether to allocate, but which ones to choose...



Source: Aberdeen Asset Management, 31 October 2017.

Common conversations in today's markets

Alternative financing



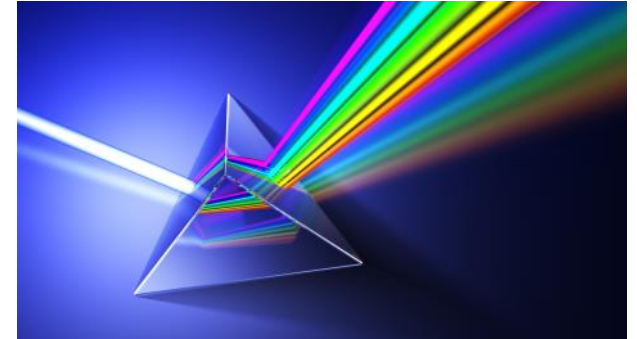
- Higher credit premia from newer forms of financing
- Opportunities for floating rate / shorter duration exposure, providing return-seeking potential in a rate rising environment

Real assets



- Private market opportunities in real assets
- Opportunities for long-term cash flows and inflation sensitivity backed by large physical assets
- Potential for sustainability theme

Systematic risk premia



- Transparent, replicable, intuitive and persistent risk premia
- Opportunity to efficiently and cheaply access highly diversifying sources of return – helping reduce volatility and provide more ways to generate returns

Alternative financing – a rich opportunity set



Source: Aberdeen Asset Management

Alternative financing – a rich opportunity set



- Floating rate senior secured corporate loans
- Expected return of L+4-6%pa with a high level of income
- Potential for outperformance in a rate rising environment

Source: Aberdeen Asset Management

Alternative financing – a rich opportunity set



- Stepping in to replace banks in the financing of airlines
- Portfolios of planes with long-term leases to airlines
- Attractive running yield, underpinned by the physical asset

Corporate lending

Asset-Backed

Speciality finance

Source: Aberdeen Asset Management

Alternative financing – a rich opportunity set



- Trade finance intermediated and financed by banks is \$6.5-\$8 bn annually*
- Attractive investment opportunity stemming from Basel III making trade finance an intense user of regulatory capital for banks

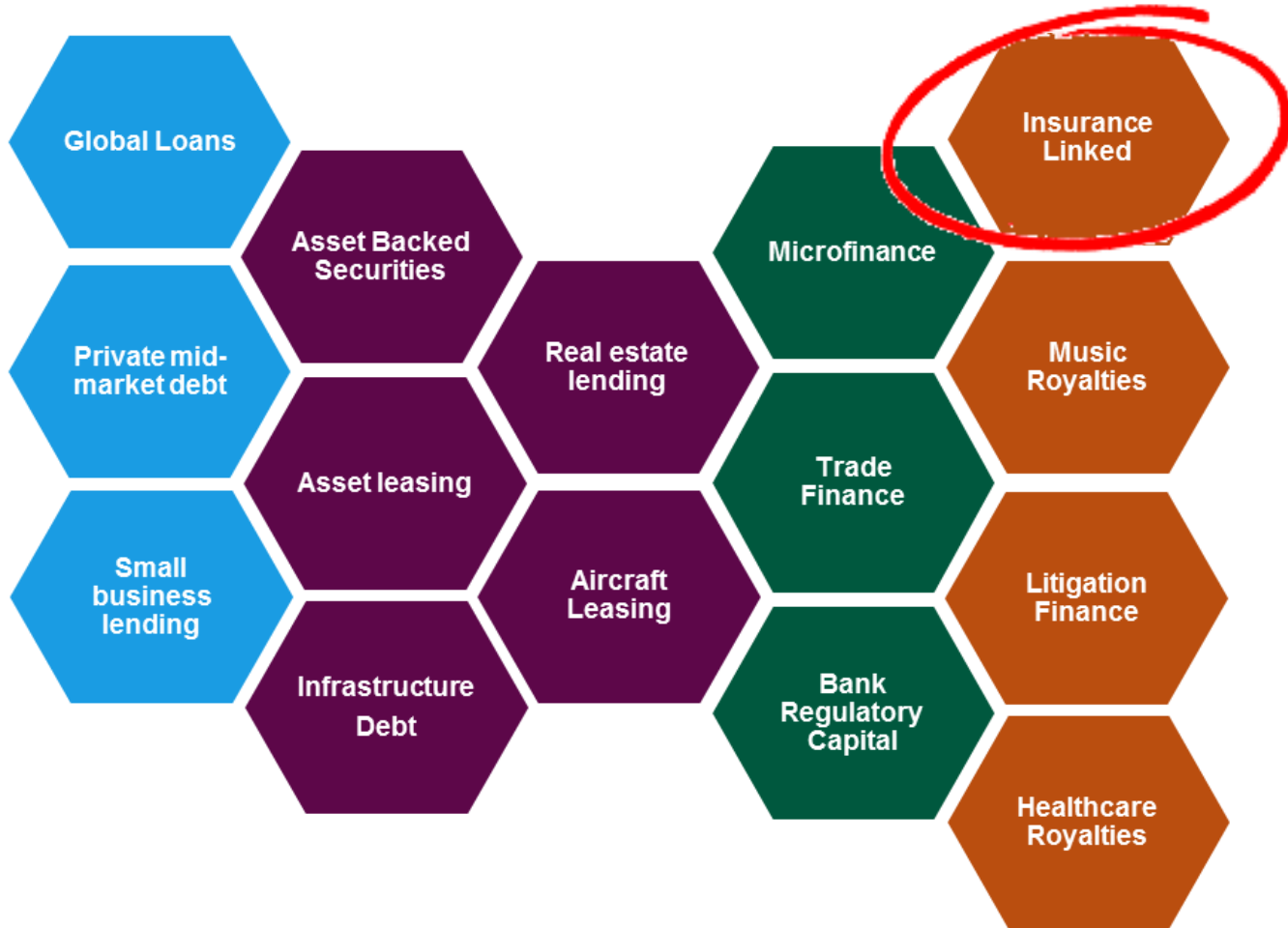
Corporate lending

Asset-Backed

Speciality finance

Source: Aberdeen Asset Management. * Bank for International Settlements, Jan 2014.

Alternative financing – a rich opportunity set

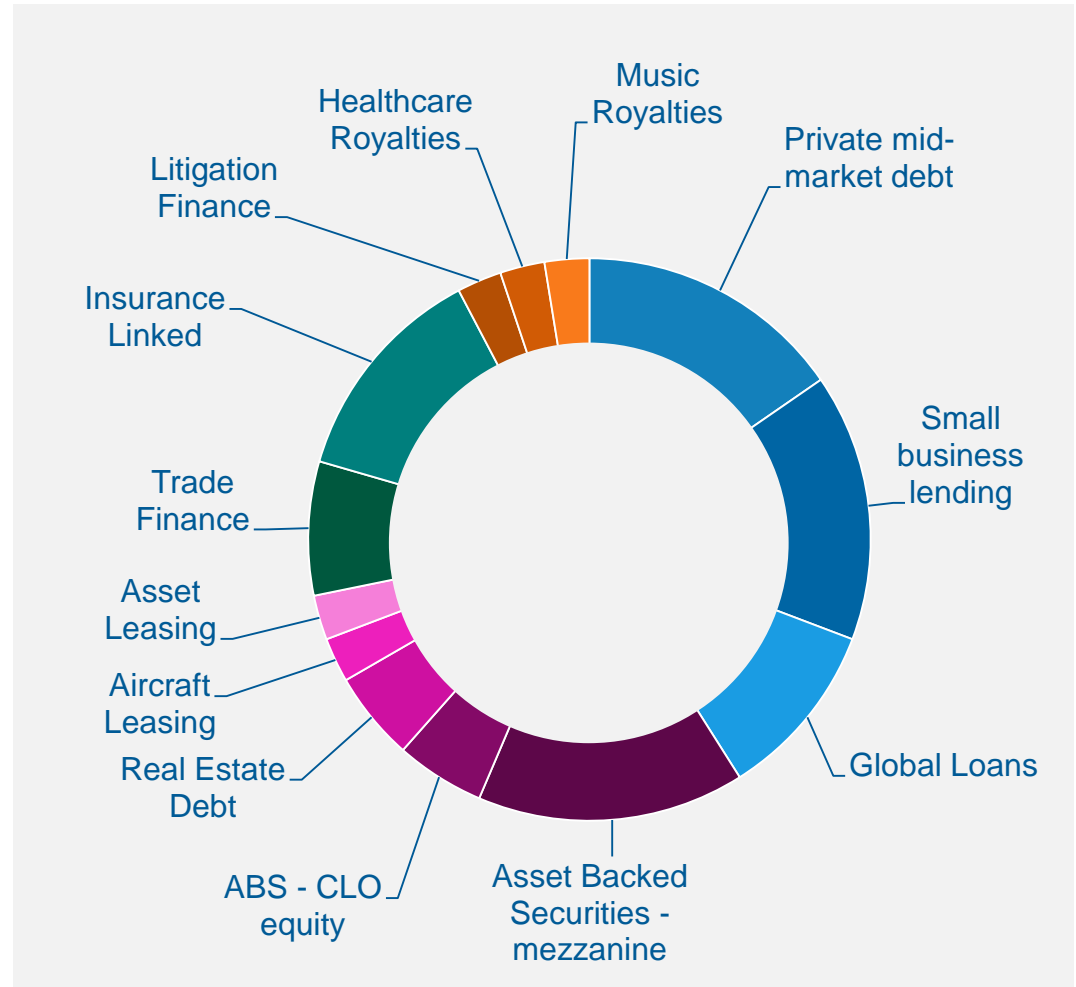


- Contracts providing cover against insurance losses due to extreme natural catastrophes
- Diversified across perils to mitigate impact of any one extreme event
- Asset class has no economic exposure and hence is uncorrelated to equities and other asset classes

Source: Aberdeen Asset Management

Alternative financing – a current client example

- We have been approached to develop a **“diversified alternative credit”** proposition for a large UK institutional investor
- Higher returns achieved through the hard-to-access nature of these investments rather than taking on excess credit or economic risk
- Risk reduced through diversification rather than holding lower returning asset classes – all investments are expected to produce a meaningful return in excess of cash



Source: Aberdeen Asset Management, Oct 17. Theoretical investment characteristics and guidelines for the concept fund

Better opportunities in less traditional real assets

Key Benefits

1

Inflation Hedge

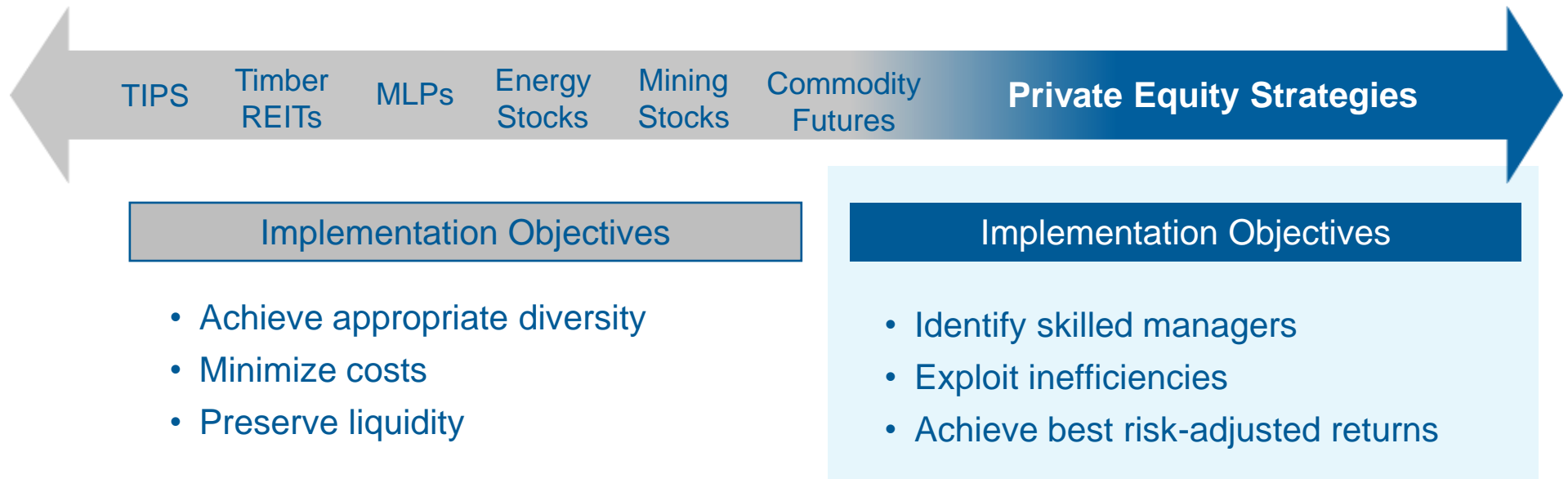
2

Diversification

3

Outperformance

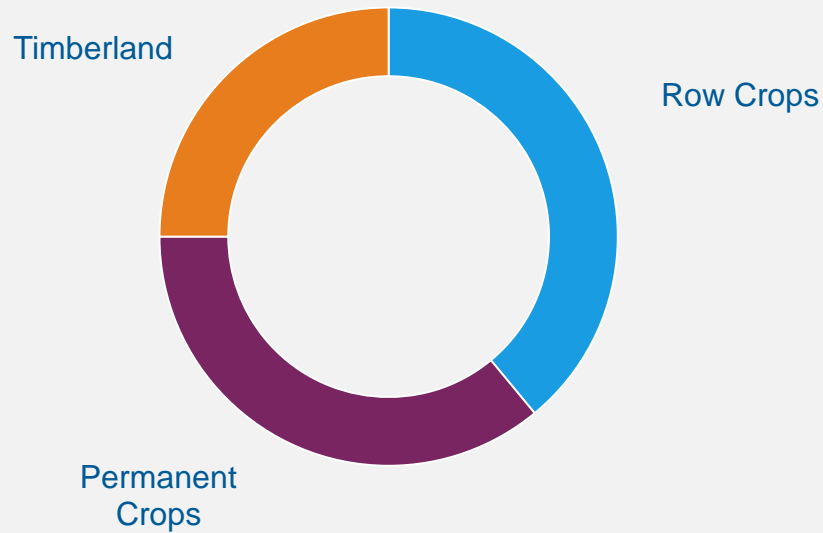
- Portfolio benefits of real assets can be achieved via multiple options
- Allocation to alternative strategies should emphasize unique opportunities available in private markets



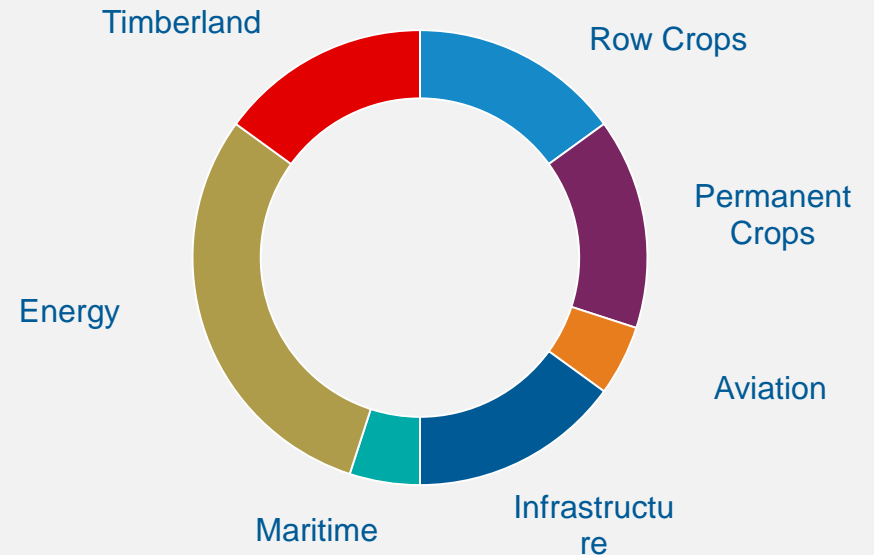
For illustrative purposes only

Real assets – current client examples

North American Timber and Ags mandate
Long-term return target of Cash+6%pa



Diversified real assets (ex property)
Long-term return target of Cash+8-10%pa



Source: Aberdeen Asset Management, Nov 17

For illustrative purposes only. Hypothetical positions are used here and actual markets conditions may have a different impact on the portfolio. No assumptions regarding future performance should be made

For many investors, diversification has been hard to reach



Transparency

Illiquidity

Regulation

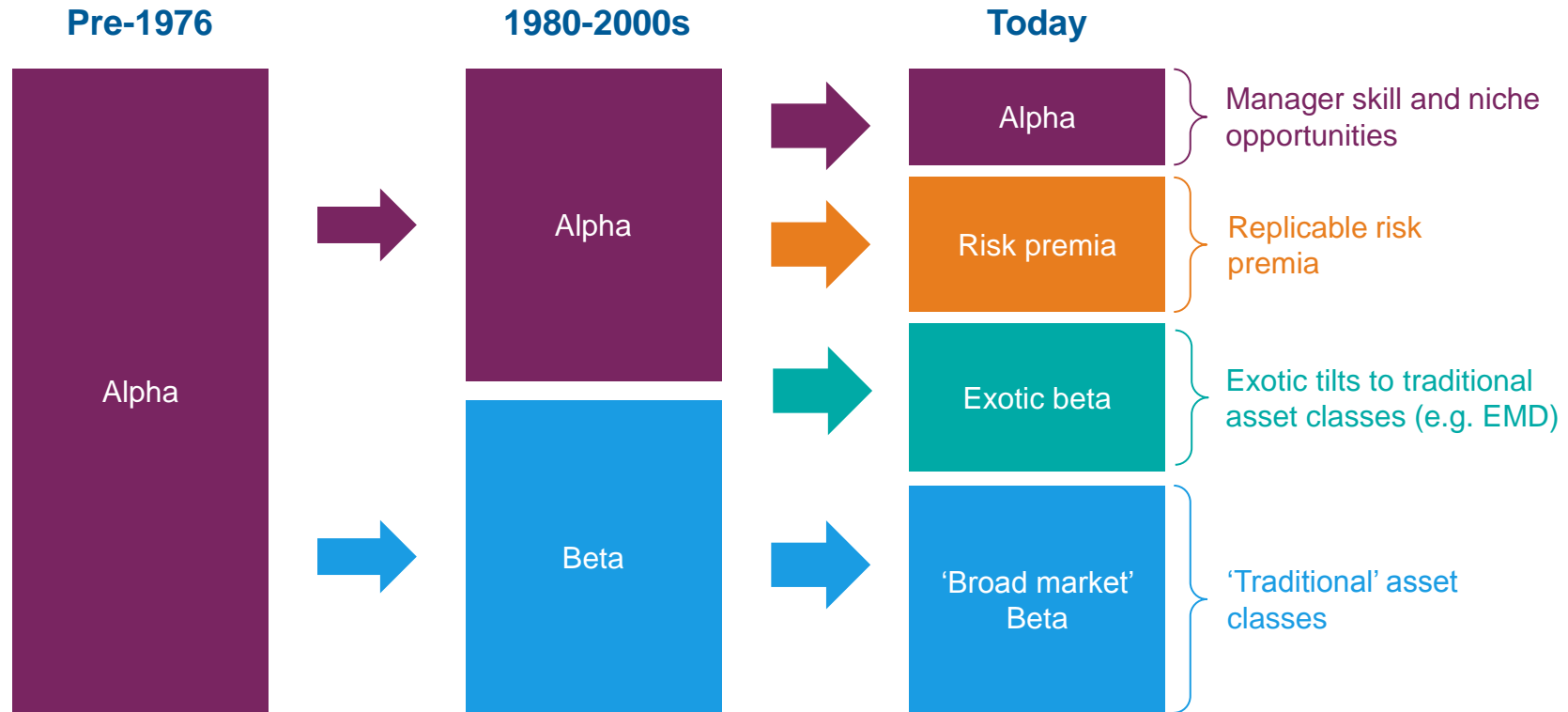
Fees

Sourcing

Governance

Source: Aberdeen Asset Management

Making the complex more accessible – risk premia

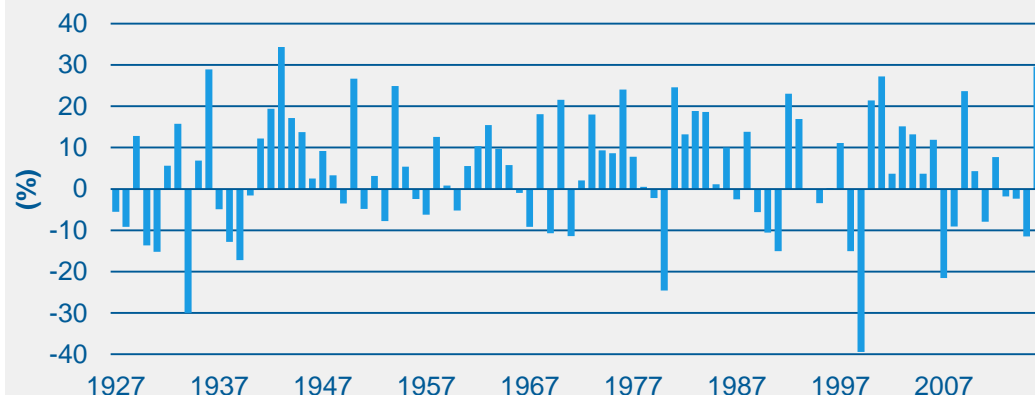


Source: Aberdeen Asset Management

Case study - value

- The idea of “buying cheap” is a long-term goal of investors
- Graham and Dodd set out the case for value investing in equities in 1934 in their book “Security analysis”
- Value in equities can be defined as a low price relative to, for example, the earnings being generated by the company or the company’s book value
- The value concept also applies in other markets – for example purchasing power parity was identified as a driver of currency markets by Cassel in 1918
- The Economist regularly publishes the “Big Mac” index as a light-hearted way to illustrate overvalued and undervalued currencies on a PPP basis

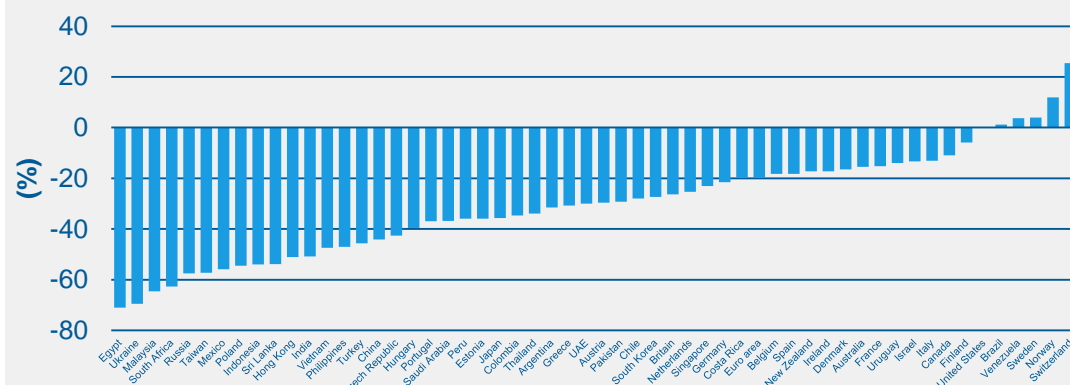
Fama-French value factor (HML) calendar years 1927-2016



Past performance is no guarantee of future results

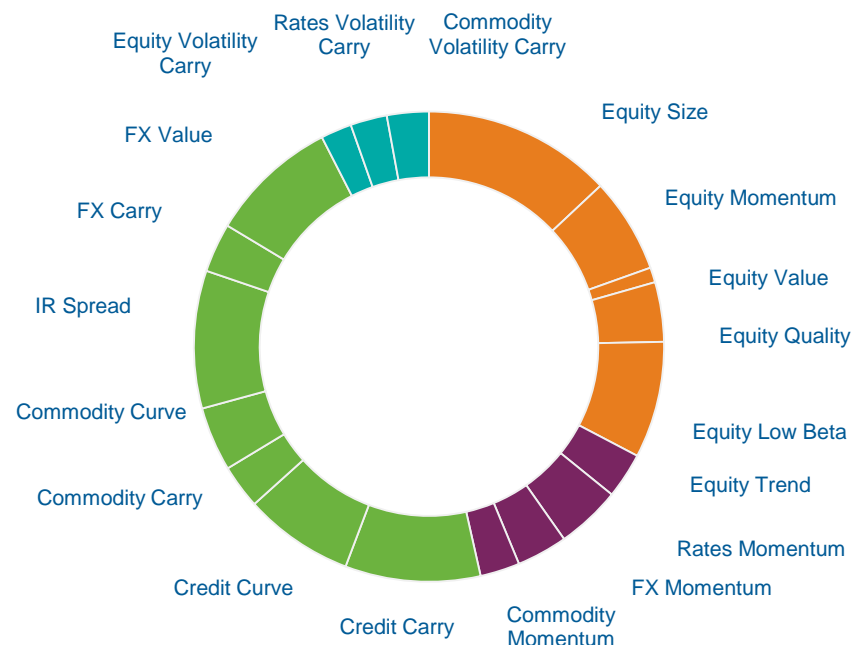
Source: HML (High Minus Low) is the average return on value stocks less the return from growth stocks. See Fama/French, 1993, “Common Risk Factors in the Returns on Stocks and Bonds,” *Journal of Financial Economics*

Relative currency valuation based on “raw” Big Mac index



Source: The Economist. Raw index provides a simple comparison of Big Mac pricing in various countries; it does not take into account the relative wealth of different countries, local labour costs etc. Aug 2017.

Risk premia – a current client solution



Balanced blend

Simply and efficiently implemented

Accessible and cost effective

Source Aberdeen Asset Management, as of 30 Sept 2017

Responsible investing – a key part of alternatives investing

"A review of the material ESG considerations that may impact an investment decision is now a fundamental element of our alternatives investment process. Assessing an investment holistically is important for both risk protection and opportunity identification."

Andrew McCaffery
Alternatives



"As a long term investor, we consider the strategic management of our environmental and social impacts as central to our future success, and we seek to embed consideration of responsible investment issues in all aspects of our activities."

Pertti Vanhanen
Property



"We are committed to promoting high standards of practice in the hedge fund industry, and look forward to working with clients to adopt forward-looking ESG investment approaches while accessing talent within the hedge fund space."

Russell Barlow
Hedge Funds



Stewardship: Alternatives

Building value for the longer term
Integrating environmental, social and governance (ESG)
issues into our alternatives investment processes



Aberdeen

Stewardship: Equities

Building value for the longer term
Integrating environmental, social and governance (ESG)
factors into our equity investment process



Aberdeen

Stewardship: Fixed income

Building value for the longer term
Integrating environmental, social and governance (ESG)
factors into our fixed income investment process



Aberdeen

Stewardship: Property

Building value for the longer term
Integrating environmental, social and governance (ESG)
factors into our direct property investment process



Aberdeen

Conclusion

More opportunities

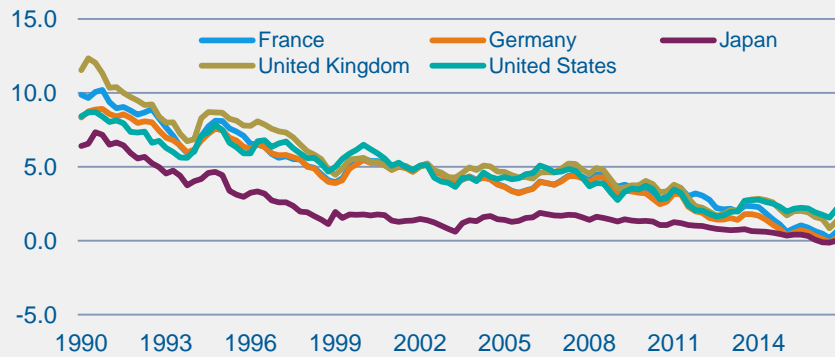


Ability to tailor



Important in today's market

Low bond yields (%)



Source Aberdeen Asset Management, Dec 2016

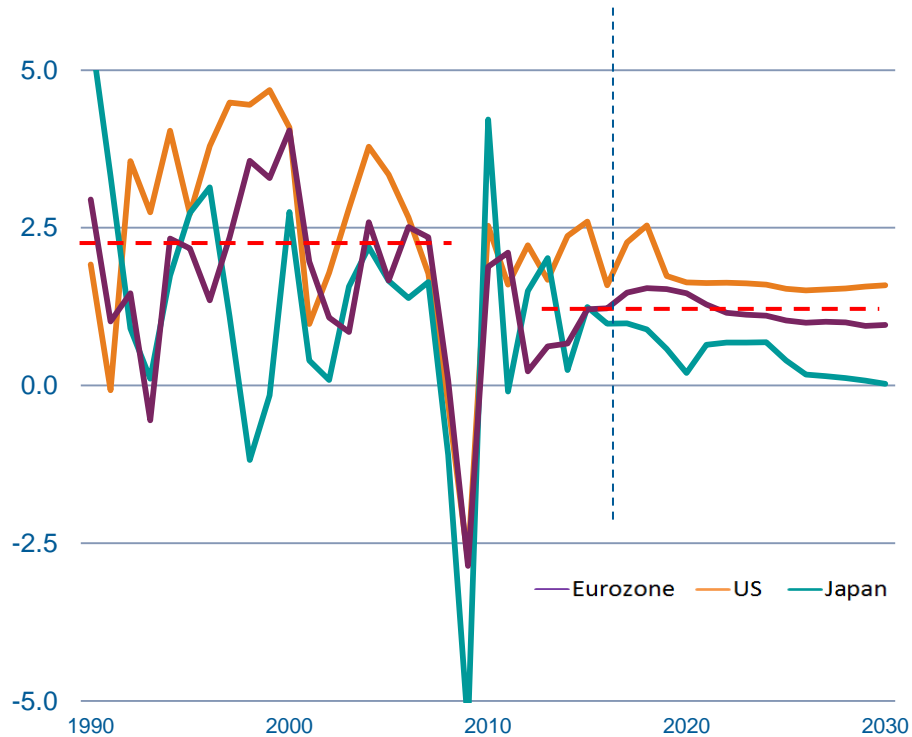
Questions?



Appendix

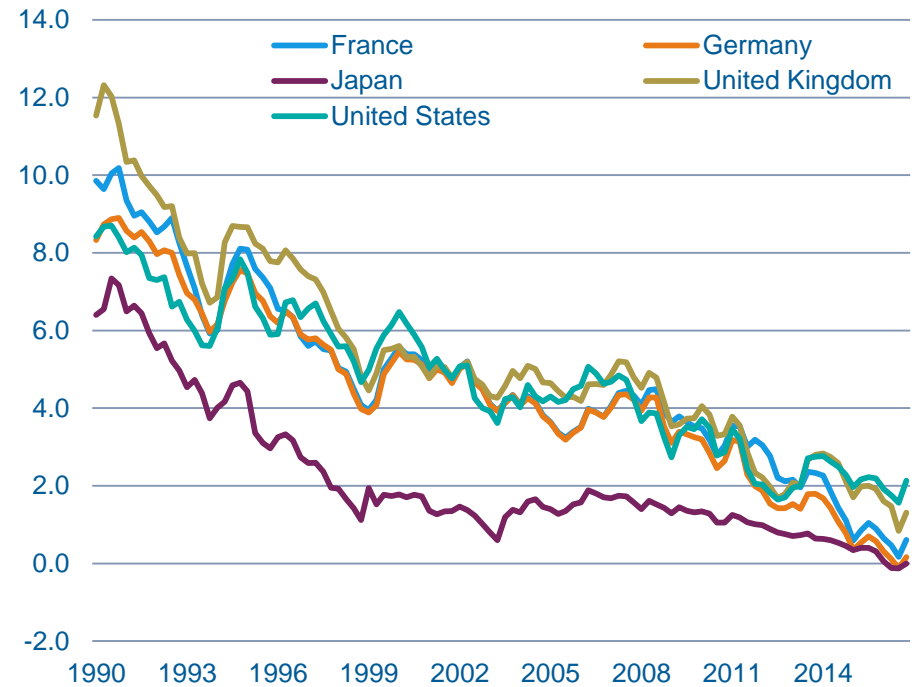
Market challenges

High growth to lower expected growth



Source: Oxford Economics, Aberdeen Asset Management. December 2016

QE and falling bond yields



Source: Aberdeen Asset Management. December 2016

Shared challenges: our perspectives

- Returns – lower for longer?
 - Economies converging to more modest growth rates
 - Lower yield environment persists
 - Political volatility delivering longer term spending and investment uncertainty
 - Increased importance of inflation hedging strategies
 - Capital preservation desire
- Governance requirements increasing
 - Scope of due diligence is widening
 - e.g. Operational due diligence as important as Investment due diligence
 - Qualitative benefits from ESG – now delivering quantifiable returns
- Mandate design
 - Unintended outcomes through lack of transparency
 - e.g. fee structures
 - J Curve mitigation
 - Track record more important than ever
 - How has it been delivered and can it be maintained?

“Alternatives” provide a broader opportunity set

Factor Asset class	Corporate earnings	Credit/insurance	Illiquid opportunities/ value add	Real assets	Niche premia and alpha	Least risk/Tail risk hedges
Traditional assets	Public market equity (developed and emerging)	Domestic IG Credit Global IG Credit				Dev. Sovereign Cash
Exotic beta	Frontier equity	EMD and high yield Catastrophe Risk Trade Finance		Commodities	Alternative risk premia Merger Arbitrage	Volatility
Hedge funds	Long/short equity Event driven equity	Long-short credit Event driven credit	Distressed debt	RMBS funds	Global Macro Equity Market Neutral Relative Value	Tail risk hedge funds
Private equity	Listed private equity	Private debt	Venture Capital Growth Buy-out	Energy Farmland Timberland		
Property		Real estate debt	Value-add property	Real Estate Investment Trusts Core property		
Infrastructure		Infrastructure debt		Core Infrastructure		

Options given
significant liquidity/fee
constraints

Options given some
liquidity/fee constraint

Options given no
liquidity/fee constraint

Source: Aberdeen Asset Management, 31 March 2017.

Alternatives – the key pillars of our investment approach

Specialist managers

In depth proprietary research to identify best-in-class managers and opportunities

Source opportunities from across global network of specialist researchers



Operational due diligence

Maintain independence in operational due diligence

If the legal, governance or administrative structure is not acceptable: **do not invest**



Broad insights

Strategy specialist teams operating within a pan-alternatives structure

Shared insights within and across research groups



Thoughtful portfolio construction

Tailored portfolio solutions aligned to specific client objectives

Risk must be continually assessed in multiple ways

Customized solutions; engaged client relationships

- Across our alternatives business we actively track over 1000 managers and investment opportunities, helping us to identify the most compelling investments for every portfolio
- As well as commingled offerings, we run multiple customised alternative mandates as well as provide broader advisory services

Notable client relationships across alternatives:

- \$6.0 billion for a \$60 billion US state pension – hedge fund and real assets
- \$100 million pa commitments for a US public plan – natural resources
- \$1.3 billion for one of the largest pension groups in Japan – customised hedge fund portfolio
- €200m for Swedish insurance company – global property
- €900m for €440bn Dutch pension provider – European direct infrastructure
- \$350m for a European private investment manager – private equity co-investments
- £350m for a UK local authority pension fund – pan-private market portfolio

Source: Aberdeen Asset Management, 31 March 2017. For illustrative purposes only.

Successful alternatives blends insight and implementation

Portfolio design and insight

- Requires deep understanding of investor requirements
- Identification of highest conviction opportunities – to meet goals, respond to market environment and utilise best managers
- Harnesses the strength of the specialist alternative teams in combination with cross-asset insights



Practical implementation and management

- Effective implementation can maximise value of investment insights
- Fund structuring and mandate negotiation can address hurdles of alternative investing
- Legal and operational due diligence important to avoid slippage
- Experienced in the nuances of managing alternative investments – for example cash flow management

Source: Aberdeen Asset Management, 31 March 2017.

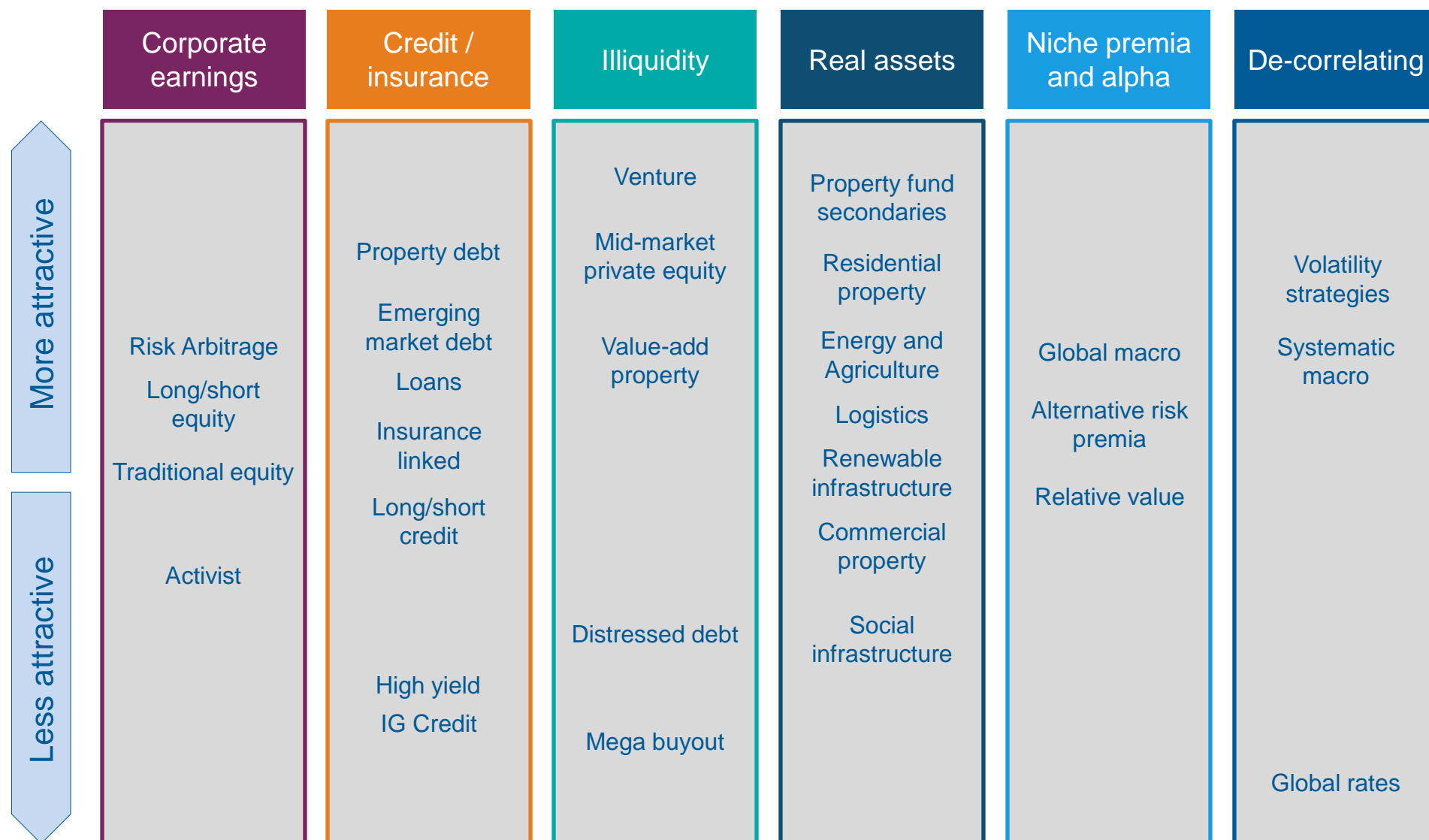
Portfolio design

- **Objectives and constraints** - setting expectations for the alternatives portfolio and identifying restrictions in the implementation
- **Structural framework** - The basis for the high level allocation either across asset classes, risk factors or outcomes
- **Liquidity budgeting** - Identifying the available illiquidity budget and the practical structure for allocating it
- **Macro and thematic outlook** - Setting the backdrop for allocating within sleeves as well as the basis for tilting the between sleeves
- **Portfolio review and modelling** - Initial portfolio modelling and/or assessment of existing exposures on both a quantitative and qualitative basis
- **Bottom up opportunities** - Identification of high quality investments to implement the strategy; opportunistic allocations for consideration outside of the structural framework



Current pan-alternative views

Views of the Pan-Alternatives Investment Committee, summer 2017



Identifying bottom up opportunities

- Across our alternatives business we actively track over 1000 managers and investment opportunities, helping us to identify the most compelling investments for every portfolio

Australian mezzanine real estate debt

- Global Winning cities theme
- Identified local opportunity and specialist third party partner to execute
- Exclusive programme for Aberdeen-managed clients
- Mezzanine loans/preferred equity in residential developments in major Australian cities



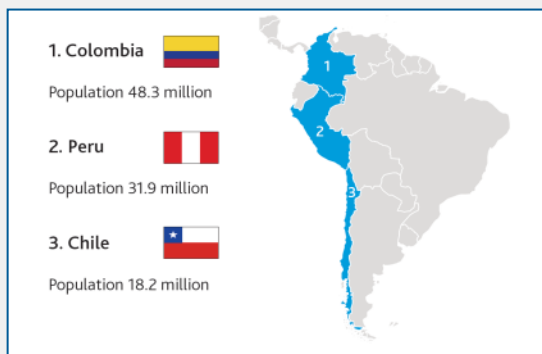
US agriculture

- Inefficiencies in US agriculture by state and by owner
- Lower productivity in smaller family owned farms
- Generational change leading to transaction opportunities
- Specialist access via third party manager



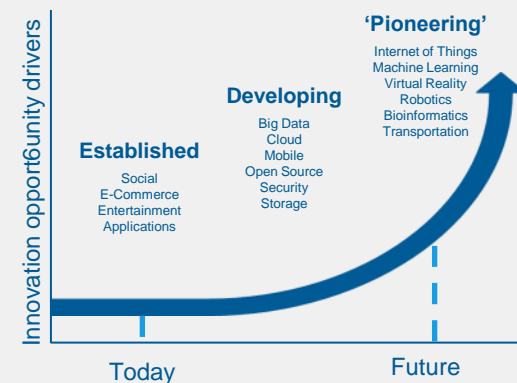
Andean infrastructure

- High demand for social infrastructure across Andean region
- Investment structuring consistent with Aberdeen experience as pioneer of direct PPP investing
- Selected by local investor to be investment partner



Venture Capital

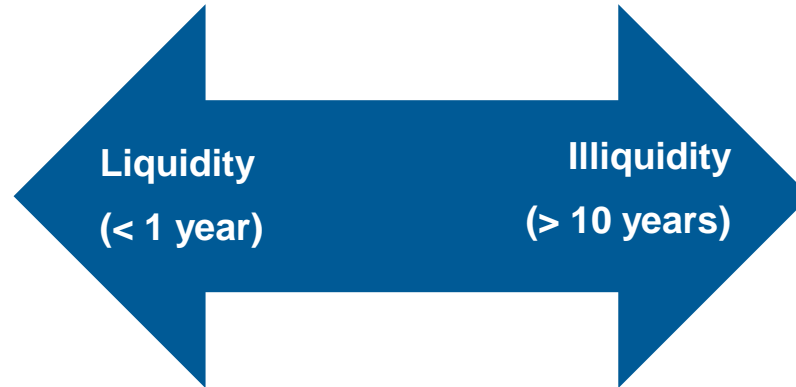
- Falling costs of company creation, technological change and globalisation leading to new VC opportunities
- Early stage venture provides optimal entry point
- Ability to access to established managers and value add from "new elite"



Source: Aberdeen Asset Management, Dec 16. Investment examples shown for illustrative purposes only. **Past performance is not a guide to future results**

Asset liquidity tends to be a barbell

- Exotic credit (e.g. frontier debt, convertibles, global loans)
- Property and REITS
- Hedge funds
- Alternative risk premia
- Listed alternatives
- Insurance-linked securities



- Value add property
- Private equity
- Venture capital
- Timberland and agriculture
- Mining
- Infrastructure

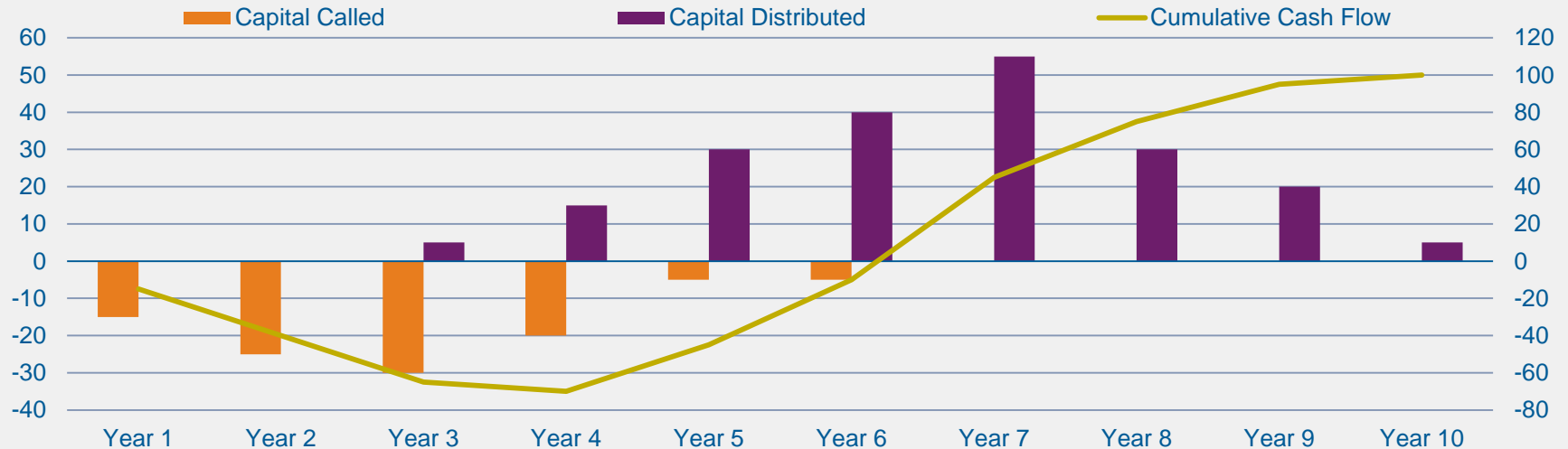


- Secondary market transactions in illiquid assets
- Some debt origination strategies
- Distressed debt
- Opportunistic private market allocations

Liquidity can be as important on entry as exit

- Illiquid investments tend to be slower to access as well as exit
- Typical closed-ended funds drawdown over a number of years
- Future commitments need to be made into additional (subsequent) vehicles

Commitment, drawdown and repayment – illustrative cashflows



Source: Aberdeen Asset Management.

Important Information

Important information: For professional investors only – not for public distribution

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